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BEFORE THE ARIZONA CORPORATION COMMISSION

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COMMISSIONERS

TOM FORESE – Chairman
BOB BURNS
DOUG LITTLE
ANDY TOBIN
BOYD DUNN

Arizona Corporation Commission

DOCKETED

APR 3 2017

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IN THE MATTER OF THE APPLICATION
OF ARIZONA PUBLIC SERVICE
COMPANY FOR A HEARING TO
DETERMINE THE FAIR VALUE OF THE
UTILITY PROPERTY OF THE COMPANY
FOR RATEMAKING PURPOSES, TO FIX
A JUST AND REASONABLE RATE OF
RETURN THEREON, TO APPROVE
RATE SCHEDULES DESIGNED TO
DEVELOP SUCH RETURN.

DOCKET NO. E-01345A-16-0036

IN THE MATTER OF FUEL AND
PURCHASED POWER PROCUREMENT
AUDITS FOR ARIZONA PUBLIC
SERVICE COMPANY.

DOCKET NO. E-01345A-16-0123

ARIZONA INVESTMENT COUNCIL'S NOTICE OF FILING

Arizona Investment Council ("AIC") hereby provides notice of filing the Direct
Testimony in Support of Settlement Agreement of Gary Yaquinto in the above-
referenced matter.

RESPECTFULLY SUBMITTED this 3rd day of April, 2017.

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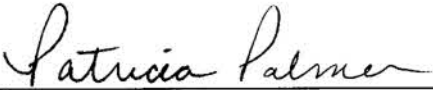
A PROFESSIONAL ASSOCIATION
ATTORNEYS AT LAW

1 **Original and 13 copies** filed this
2 3rd day of April, 2017, with:

3 Docket Control
4 Arizona Corporation Commission
5 1200 West Washington Street
6 Phoenix, AZ 85007

7 **Copies** of the foregoing mailed
8 this 3rd day of April, 2017, to:

9 All Parties of Record

10 
11 _____

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Direct Testimony of Gary Yaquinto in Support of Settlement Agreement

On Behalf of

Arizona Investment Council

April 3, 2017

1 **Q: Please state your name, position and business address.**

2 A: Gary M. Yaquinto. I am the President and CEO of Arizona Investment
3 Council ("AIC"). Our offices are located at 2100 North Central Avenue,
4 Phoenix, Arizona 85004.
5

6 **Q: Have you previously filed testimony in this proceeding?**

7 A: Yes, I filed direct testimony on February 3, 2017. Additionally, Branko Terzic
8 filed direct testimony on December 28, 2016 and February 3, 2017, and Dan
9 Hansen filed direct testimony on February 3, 2017.
10

11 **Q: What was the purpose of your testimony here?**

12 A: The purpose of my testimony is to support the Settlement Agreement reached
13 in the Arizona Public Service Rate Case proceeding.
14

15 **Q: Is AIC a signatory to the Settlement Agreement?**

16 A: Yes. We participated with the other parties in the discussions and negotiations,
17 which led to the execution of a Settlement Agreement.
18

19 **Q: Were settlement discussions open, transparent and fair to all parties?**

20 A: Yes. All parties were provided notice of meetings to discuss the possibility of
21 settlement and afforded ample opportunity to participate in the discussions.
22 The result was an agreement in which the signatories reached a compromise on
23 various issues.
24

25 **Q: Why does AIC support the Settlement Agreement?**

26 A: AIC supports the Settlement Agreement because it contains provisions that
27 represent a reasonable compromise of the various parties' positions and that
28 reasonably benefit APS, its customers, and its shareholders. Because the

1 Settlement Agreement was reached through a give-and-take consensus process,
2 AIC believes that the outcome is balanced and produces a more efficient
3 resolution compared to one accomplished through a fully litigated proceeding.
4 Credit rating agencies also look favorably on Settlement Agreements reached
5 in rate proceedings because settlement often results in a more expedient and
6 creative resolution of issues that balance the positions of diverse parties,
7 including provisions that are credit supportive. The consensus achieved during
8 a settlement is often viewed as indicative of a positive regulatory environment,
9 which enhances a utility's credit quality. Additionally, reaching a settlement
10 could result in timelier implementation of new rates than if the rate case had
11 been fully litigated.

12
13 **Q: What provisions of the Settlement Agreement are of particular**
14 **importance to AIC?**

15 A: There are a number of provisions contained in the Settlement Agreement that
16 will enhance and support the financial health of APS. Those provisions
17 include a non-fuel, non-depreciation revenue increase of almost \$90 million; a
18 10 percent return on equity; deferred recovery of installation costs for selective
19 catalytic reductions (SCRs) at Four Corners Generating Station; a cost deferral
20 for the Ocotillo Modernization Project (OMP); a cost deferral related to
21 changes in the Arizona property tax rate; creation of a tax expense adjustor
22 mechanism; and updated residential rate designs.

23
24 **Q: Please describe the Cost of Capital provisions and why AIC supports**
25 **them.**

26 A: The parties agreed to an original cost of capital structure comprised of 44.2
27 percent debt and 55.8 percent common equity, with a return on equity of 10.0
28 percent and a 5.13 percent embedded cost of debt. The fair value rate of return

1 will be set at 5.59 percent with a return on fair value increment of 0.8 percent.
2 See APS Settlement Agreement §5.

3
4 The cost of capital provisions are consistent with previous Commission
5 treatment of APS's capital structure, and other similar vertically integrated
6 electric utilities. They should allow the Company to maintain and/or continue
7 to improve its financial condition and credit ratings over time.

8
9 **Q: Please describe the rate treatment agreed upon regarding the installation**
10 **of SCRs at Four Corners Generating Station Units 4 & 5.**

11 A: The Settlement Agreement allows APS to defer for possible future recovery
12 through rates all non-fuel costs of owning, operating, and maintaining the
13 SCRs installed at Four Corners from the date they go into service until the end
14 of 2018, at which time APS will file a request to include them in rates through
15 a step increase. The Agreement provides that this docket will remain open for
16 APS to make that request, and, if the request is approved, APS's rates will
17 reflect the addition of the SCRs no later than January 1, 2019. See APS
18 Settlement Agreement §9.

19
20 **Q: Please describe the agreed upon cost deferral related to the Ocotillo**
21 **Modernization Project.**

22 A: The Settlement Agreement allows APS to defer for later recovery through rates
23 all non-fuel costs of owning, operating, and maintaining the OMP, and retiring
24 the existing steam generation at Ocotillo. Because the OMP is anticipated to
25 be in-service prior the effective date of APS's next general rate case, the
26 entirety of the OMP investment will be addressed and resolved in that
27 proceeding. See APS Agreement §10.

1 **Q: Please describe the cost deferral for property taxes?**

2 A: APS can defer for either future recovery or credit to customers, Arizona
3 property tax expense that is above or below the test year caused by changes to
4 the applicable Arizona composite property tax rate. *See* APS Settlement
5 Agreement §11.
6

7 **Q: Why are cost deferrals for large investments made between rate case test**
8 **years appropriate?**

9 A: Cost deferrals, such as those allowed by this Settlement Agreement, help
10 companies mitigate the negative financial consequences of regulatory lag
11 resulting from significant capital plant investments without impacting current
12 customer rates. Because the timing of both the installation of the SCRs and
13 construction of the OMP are far enough removed from the test year, the parties
14 could not agree to include them in the revenue requirement provided in the
15 present rate case. However, both of these projects are necessary and will be in-
16 service and used and useful to customers shortly after the present rate case
17 concludes. Thus, absent an accounting order authorizing deferral of the costs
18 of these investments, expenses are booked as incurred, immediately lowering
19 APS's reported earnings.
20

21 The cost deferrals authorized by the Settlement Agreement are consistent with
22 sound regulatory policy. The parties' willingness to use innovative measures
23 such as these to mitigate the financial impact of regulatory lag sends a positive
24 message to the industry and Wall Street that the Commission supports the
25 financial integrity of the Company through periods of high capital
26 expenditures. Additionally, these mechanisms promote rate gradualism and
27 prevent the Company from filing pancaked rate applications. This benefits the
28 Company, its customers, the Commission and the public in general.

1 Additionally, accounting orders are consistent with previous Commission
2 decisions. Most recently, APS was granted an accounting order when it
3 acquired Southern California Edison's share of the Four Corners Power Plant.¹
4 Consistency of regulatory treatment is closely linked to regulatory risk;
5 consistency reduces risk, which can increase a Company's creditworthiness,
6 lowering the cost of capital and ultimately benefiting the customers through
7 lower rates.

8
9 **Q: What is the Tax Expense Adjustor Mechanism (TEAM)?**

10 A: Should significant federal income tax reform legislation be enacted and
11 become effective prior to the conclusion of APS's next general rate case, and
12 should the legislation materially impact the Company's annual revenue
13 requirements, APS has agreed to create a rate adjustment mechanism to enable
14 a pass-through to customers of any income tax effect. *See* APS Settlement
15 Agreement §16.

16
17 **Q: Why is the TEAM in the public interest?**

18 A: Changes to the federal income tax code are unknown at this time and outside of
19 APS's control, and therefore are not included in this proceeding's analysis.
20 However, if federal legislation decreases income taxes, the TEAM adjustment
21 would pass the tax benefit on to customers in between rate cases.

22
23 **Q: Please describe the residential rate designs contained in the Settlement**
24 **Agreement**

25 A: The Settlement Agreement contains a number of residential rate design
26 changes, including new demand rate options, adjusted TOU time frames, and
27 an increased basic service charge (BSC).

28 ¹ *See* Decision No. 73130 (April 24, 2012).

1
2 The redesigned volumetric rates divide the non-distributed generation
3 residential customers into three groups based on their average per month usage,
4 with an increasing BSC of \$10 per month for customers using less than
5 600kWh per month, \$15 per month for customer using between 600-1000kWh
6 per month, and \$20 per month for customer using more than 1000 kWh per
7 month.

8
9 All customers, including distributed generation customers, will be able to
10 choose between two demand rates and a time-of-use rate – all with a \$13 per
11 month basic service charge and a weekday on-peak period of 3:00pm to
12 8:00pm. Distributed generation customers selecting the TOU-E rate will be
13 subject to the Grid Access Charge, self-consumption off-set rate, and Resource
14 Comparison Proxy Rate. *See* APS Settlement Agreement §17.

15
16 **Q: Why does AIC support expansion of APS's demand rate options?**

17 A: Residential demand rates better align residential electric rates with the cost of
18 service, provide improved cost signals to customers to promote economic use
19 of electricity, and allow customers more options to reduce monthly bills
20 through behavior modification or energy management technology. Providing
21 customers with additional demand rates options will hopefully increase the
22 subscription level of these rates, thereby helping to influence downward peak
23 demand and continue APS's progress towards rate modernization.

24 **Q: Why is it necessary for new distributed generation customers to be subject**
25 **to the Grid Access Charge, Self-Consumption Offset rate and Resource**
26 **Comparison Proxy rate?**

27 A: Electric utility customers consume energy differently than they did a hundred
28 years ago when volumetric rates became the standard. Distributed generation

1 customers in particular take, consume, and sell back power in a way that
2 differentiates them from residential customers that rely on the utility for all of
3 their power and energy needs. Under volumetric rate designs, distributed
4 generation customers often have zero or negative billed kWh during a billing
5 month, but due to the intermittency of the solar system, it is unlikely that they
6 would have zero demand. The utility's grid and other ancillary services enable
7 these customers to produce their own energy, consumer their own energy and
8 sell excess power back to the utility – rates must reflect the costs that enable
9 this behavior and not just energy sold by the utility. The Grid Access Charge,
10 Self-Consumption Offset rate and the Resource Comparison Proxy rate more
11 accurately charge a customer for the costs incurred by a utility to provide these
12 services.

13
14 **Q: Does AIC support the residential rate design options contained in the**
15 **Settlement Agreement?**

16 **A:** Yes. Although AIC would like to have seen further rate design progress, the
17 Settlement agreement provides all residential customers, both distributed
18 generation and non-distributed generation customers, optionality and
19 flexibility. The agreed-upon rate plans provide a mix of new modern rates,
20 like demand rates and TOU rates with a more accurate on-peak period, and
21 traditional volumetric rates designed for differing usage patterns. While some
22 of the rate design changes originally sought by the Company, and supported by
23 AIC, have not been adopted, the rates contained in the Settlement Agreement
24 provide a positive step forward to modernize APS's rate design.

25
26 **Q: Mr. Yaquinto, what is your recommendation to the Commission?**

27 **A:** I recommend the Commission approve the Settlement Agreement as proposed.
28

1 **Q: Does this conclude your testimony?**

2 **A: Yes.**

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